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August 2, 2000

FILED

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Missouri Public
Service Commission

Mr. Dale H. Roberts
Secretary/Chief Regulatory Law Judge
Public Service Commission
P. O. Box 360
Jefferson City, MO 65102

RE: Missouri-American Water Company
Case No. WR-2000-281, et al.

Dear Mr. Roberts:

Enclosed for filing in the above-referenced case please find the original and eight copies of **Reply Brief of the Office of the Public Counsel.** Please "file" stamp the extra enclosed copy and return it to this office.

Thank you for your attention to this matter.

Sincerely,

John B. Coffman
Deputy Public Counsel

JBC:jb

cc: Counsel of Record

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri-American Water Company's Tariff Sheets Designed to Implement General Rate Increases for Water and Sewer Service Provided to Customers in the Missouri Service Area of the Company.	)))))	Case No. WR-2000-281, et al.

REPLY BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL

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I. INTRODUCTION

This Reply Brief will present the Office of Public Counsel's (Public Counsel's) responses to arguments and misstatements contained in Missouri-American Water Company's Initial Brief ("Company" or "MAWC") and in the Initial Brief of the Staff of the Commission (Staff).[1]

Primarily, this Brief will address the issues surrounding the ratemaking treatment that should be afforded the water treatment facilities in Company's St. Joseph, Missouri district. Although Company's Initial Brief discusses these issues in a combined way, it is important to recognize that there are two distinct issues that the Commission must address related to the St. Joseph treatment facilities:

1) The appropriate valuation for the St. Joseph water treatment facilities, based upon an economic comparison of the cost alternatives.

2) The appropriate "used and useful" capacity adjustment that must made to the Commission determined valuation in order to exclude from water rates charged to of current rate-payers the excess capacity of 30 MGD that is the basis of all of the recommended valuations offered by the parties to this case.

[1] Failure of this Reply Brief to respond to any particular arguments made in the initial briefs filed in this case should not be misconstrued as acquiescence to those arguments. Many of the arguments contained in initial briefs have already been adequately addressed in the Initial Brief of the Office of the Public Counsel or were simply not supported by the record in this case and not worthy of a response.

This Brief will also address the issues of Premature Retirement, Return on Equity, and further explain why Public Counsel's various Rate Design and Phase-in recommendations are legally justified and also reflect the most reasonable approach to implementing the revenue requirement that will be adopted by the Commission.

II. Valuation of the St. Joseph Water Treatment Facilities

It is Public Counsel's strong and earnest opinion, reached after meticulously reviewing the testimony in this rate case, along with the extensive information provided through the discovery process, that Company's management made a conscious and ill-advised decision to construct an expensive groundwater treatment facility north of its existing river treatment plant for the purpose of inflating its rate base and dramatically enhancing its revenue stream. Company management made this imprudent decision knowing full-well that this was not the most economic decision available to it, because its own cost estimates for refurbishment of its river treatment facility to a comparable standard showed that approach to be extremely less expensive.

It should not be surprising that a water company would attempt to magnify its rate base in such a manner. The incentives to over-invest in rate base are inherent to the rate of return regulatory process. Therefore, the Commission must be willing to employ the regulatory remedy applicable to this situation and disallow any investment that was made in excess of what would be an economic in a comparably competitive marketplace.

It is obvious that Company's top management came to the conclusion that the 1993 Flood presented an irresistible opportunity to take advantage of a tragic situation by building a "Cadillac" system that would make any engineer "ooh" and "ahh," but which would never meet

the legal "reasonable care standard" of an objective prudence review or cost/benefit analysis. Following the 1993 Flood, Company undertook steps to obtain the support of politicians and local civic leaders in the City of St. Joseph for this extremely large project long before the ratepaying public became fully aware of the potentially dramatic consequences for its water bills.

Company then attempted to use the fact that its well field would be arguably outside of its certificated boundaries to file a certificate case with the Commission (Case No. WA-97-46) and further took that opportunity to make the unprecedented request for pre-approval of prudence. The clear purpose of that case was to co-opt the Commission's ability to evaluate the prudence and reasonableness of the ratemaking treatment for these facilities in a later rate case where all of the relevant evidence would likely be at hand. This Commission wisely declined to go along with this clever tactic, explicitly reserving any ratemaking treatment to the appropriate case – this instant rate case. See Public Counsel's Initial Brief, pp. 22-27.

Perhaps what is the most disturbing thing about the Staff's Initial Brief is the stated position that the Commission (despite its explicit disclaimer regarding the fact that it was not making a prudence finding or prejudging any ratemaking treatment related to the St. Joseph water treatment facilities) actually did preapprove prudence somehow regarding Company's choice of alternatives and that Company reasonably relied upon that purported prudence finding. Ibid. at 4. As described in Public Counsel's Initial Brief, Company did not receive the preapproval relief it requested in Case No. WA-97-46. The Commission included an explicit disclaimer in its Report and Order stating that no ratemaking determination had been made, and made no statement in that order about which alternative was the most reasonable or the most cost effective. This Commission has never preapproved prudence and certainly did not do so in Case No. WA-97-46.

Staff's stated position regarding estoppel in this case is completely at odds with the position Staff took in the analogous Union Electric Callaway Nuclear Plant certificate case (Case No. 18117) and in the subsequent rate case. This position regarding estoppel is a dramatic shift of past Staff policy, and if adopted would create a legally unenforceable, but nonetheless dangerous, precedent. If the estoppel argument is adopted the Commission could look forward to a flood of utility requests for preapproval on any number of future projects. Regulated utilities would no doubt jump at the chance to shift shareholder risk and "lock-in" future ratepayer revenues. Such a policy is contrary to the fundamentals of rate of return regulation and would be legally unenforceable.

It should be noted that, although Company goes through the motions of making the estoppel argument, its star witness regarding prudence, John Young, conceded in responses to Public Counsel Data Requests and when subjected to cross-examination, that prudence was not preapproved by the Commission in Case No. WA-97-46 (Ex. 85; Transcript 1189-1190). This is an admission that the Company did not rely on purported preapproval by the Commission.

What is truly amazing about Company's evidence presented to support its abandonment of its river treatment plant and the $70+ M investment in a new state-of-the-art groundwater facility is that this evidence does not contain any detailed engineering study or competent analysis of economic justification. (Ex. 20, p. 8). The 1996 Feasibility Study, which was presented in Case No. WA-97-46 and which was attached to the direct testimony of Mr. Ted Biddy as Schedule TLB-3, is described in Company's Brief as "inherently complex" and "sophisticated." Ibid. at 7. However, this supposedly sophisticated document provided no detailed engineering studies regarding the cost to rehabilitate or to flood-proof the river treatment facility; it merely asserts that it is "not feasible" under DNR rules (which Public Counsel has

proven to be untrue) and provides no further study or analysis. (Ex. 19, Sched. TLB-3, Exhibit A, p. 4).

The very result-oriented 1996 Feasibility Study did not even mention the 1991 Report that presented the total project costs for rehabilitating the river treatment facility at only $22.6 M, and which was subsequently approved by the Missouri Department of Natural Resources (DNR). Mr. Young acknowledged that the 1991 Report would not have been submitted unless it was based upon the best information available. (Tr. 1206). In Case No. WA-97-46, Company likely wanted the Commission to pre-approve and commit itself to a project before the 1991 Report was brought under public scrutiny. Fortunately for the public, the 1991 Report was uncovered in this rate case by two completely independent prudence reviews and provides compelling evidence regarding what Company management knew at the time it made the decision to abandon its river treatment plant.

Further illustration of the insufficiency of Company evidence to support its choice of alternatives is the sketchy document which purports to show the cash flow analysis that generated a $63.3 M price tag for the renovation of the river treatment plant (Ex. 20, Sched. TLB-3, Appendix B, p. 7; attached to this Initial Brief as Attachment 1). This document is the so-called "decision document" according to Company. However, this document is far from a detailed engineering cost estimate and interpreting it has led to substantial confusion about how Company reached its significant decision. Company bears the burden of proof to justify its decisions as prudent and reasonable. § 386.240 RSMo. 1994. However, Company presents this one-page document that it generated and which does not clearly show the costs of individual components and then blames intervening parties for creating confusion. Company Initial Brief

pp. 7-9. How can Company seriously expect to prove its prudence based upon a document so bereft of information?

Company's Initial Brief accuses Mr. Biddy of not recognizing "non-construction costs necessary to implement projects"; however it acknowledges that the 1991 Report upon which Mr. Biddy relied did indeed reflect "Company's total project cost estimate" for rehabilitation of the river treatment facility for $22.6 M. Ibid. at 8, 12. Company asserts that there is much significance to the fact that many of the estimates that were made during the past nine years referred to engineering cost estimates only; however, the fact remains that the 1991 Report, relied upon both by Public Counsel's prudence witness Mr. Biddy and Dr.Morris, the prudence witness of the Industrial Water Users, was indeed a total project cost. Company witness Young conceded that, assuming that there is agreement about the scope of a project, the best engineering estimate would generally be the one that analyzed a project's components in the most detail. It is therefore amazing that Mr. Young "hangs his hat" on the $63.3 M cash flow number which is supported by absolutely no engineering cost estimate whatsoever. Company has simply failed to meet the burden of proving its prudence.

Significantly, Company chose to spend much of its Initial Brief engaged not in an analysis of the evidence, but in an ad hominen smear attack upon engineering witnesses Mr. Biddy and Dr. Morris. Ibid., pp. 3-15, 22-34. These sections of its brief are replete with inflammatory mischaracterizations of the issues that have been raised by Public Counsel and are accompanied by several citations that grossly misattribute the referenced evidence to unsupportable allegations.

On page three of Company's Initial Brief, Company makes the completely false and unsupportable allegation that Public Counsel and the Industrial Water Users "admitted collusion in their testimony preparation."[2] Ibid. Company's Brief then states that the Industrial Water Users acknowledged receiving testimony from Public Counsel in advance of its simultaneous filing and cites page 1139 of the Transcript. Id. When page 1139 of the transcript is reviewed, the Commission will find absolutely no reference to the Office of the Public Counsel; instead, it contains a discussion about discovery difficulties between Company and the Industrial Water Users. Unfortunately, this is not the only irresponsible citation in Company's Brief. For example, on page 26 of its Initial Brief, Company states that Mr. Biddy was directed to certain dates in the 1996 Feasibility Study, and implies that Mr. Biddy acknowledged an error, citing pages 1420 and 1421 of the transcript to support the statement. Ibid. Again, a reading of the cited transcript pages will reveal something different. These pages do not contain not the testimony of Mr. Biddy, but rather the redirect testimony of Company witness John Young. (Tr. 1420-1421).

Company counsel attempted to disparage Mr. Biddy's testimony in this case by pointing out that he was a hired consultant and that his convictions are transparently "for sale." Company's Initial Brief, p. 22. Public Counsel has no in-house water engineer. Mr. Biddy was hired by Public Counsel to perform a prudence review after offering a winning bid for the work

[2] Nothing could be further from the truth. Neither Mr. Biddy nor Dr. Morris reviewed the others' prepared testimony before it was filed in this case. Mr. Biddy and Dr. Morris met for the first time at the evidentiary hearing and at no time discussed the subject of their testimonies with each other. The relative similarity of the recommendations for valuing the St. Joseph water treatment facilities (Mr. Biddy-$38.5 M; Dr. Morris-$40.3 M) is based upon two different methodologies and is compelling proof that a valuation in this range is just and reasonable.

and was not asked at any time to reach any predetermined conclusion regarding prudence. (Tr. 1632).

Company attorney, Mr. Ciottone, attempted to use statements contained in Mr. Biddy's response to Public Counsel's Request For Proposal to the effect, that he had a "gut feeling" that an upgrade of the existing river treatment plant could have been performed at a fraction of the cost of the new groundwater facilities as an indication that Mr. Biddy had made up his mind before beginning a prudence review. (Tr. 1631-1636). However, Mr. Biddy pointed out that those statements were actually made after a careful review of a majority of the relevant documents in this case, including all of the documents submitted in Case No. WA-97-46, the prepared direct testimony of Company witness John Young, and the estimated construction costs for the new groundwater facility. (Tr. 1632-1633). Of course, if the Commission is to seriously question the credibility of a witness simply because they are a hired consultant, the Commission could question the credibility of Company witnesses Mr. Walker, Mr. Hamilton, and Mr. Salser, all of whom are consultants hired by Company to testify in this proceeding.

Company's last defense to a prudence disallowance is the claim that the financial impact of such a disallowance would be grievous to shareholders. While acknowledging that the Commission should never avoid making a disallowance when imprudence has been proven, Company proceeds with its attempt to scare the Commission into believing that the corresponding financial impact on its shareholders should be balanced against the duty to set just and reasonable rates. Company's Initial Brief, pp. 89-90. Company claims that its situation should be distinguished from the electric utilities that experienced rate base disallowances in the 80's and 90's because those disallowances occurred at the end of a construction cycle. Id. Company then claims that it is not at the end of its construction cycle; however, with regard to its

St. Joseph water treatment facilities this is not true and Company provides no evidence to support this claim.

Company claims that Public Counsel has not demonstrated that its recommended return on equity together with a plant disallowance would allow Company to engage in "reasonable permanent financing." Id. at 90. Despite the fact that Company bears the burden of proof in a rate case, Public Counsel has provided substantial affirmative evidence that, even with the highest recommended disallowance in this case and using Public Counsel's recommended rate of return, Company's times-earned-ratio would still be greater than is required by the restrictive covenant of its indenture. (Ex. 26, p. 5).

Company further suggests that if the Commission adopts a plant disallowance, that it will become riskier, and thus it would deserve a higher return on equity. Company's Initial Brief, pp. 91-93. As Public Counsel discussed in its Initial Brief, it would be inappropriate to adjust rate base downward to recognize imprudence with one hand, while with the other hand "giving back" to the Company an offsetting upward adjustment to the return on equity. As a monopoly subject to rate of return regulation, Company's return on equity already reflects the business risk that its investments are subject to prudence disallowances. The fact that a disallowance is warranted in this case does not increase that level of risk, because disallowance is inherently part of regulated utility's business risk.

The testimony of Public Counsel witness Mr. Biddy thoroughly documents the method in which he developed his cost estimate for flood proofing and refurbishing the river treatment plant, and further explains how several items in his estimate were inflated to give Company "every benefit of the doubt." Company and Staff have nonetheless suggested that various components of Mr. Biddy's cost estimate are still not high enough. Those items mentioned in

initial briefs include: Company's claim that Mr. Biddy ignored $9.2 M related to intake costs (Company's Initial Brief, p. 12), Company's claim that Mr. Biddy ignored $5.5 M that it believes would be needed for ozone facilities (Id.), and Dr. Morris estimates that flood protection costs would be approximately $1.5 M greater than Mr. Biddy's flood proofing costs estimates (Ex. 91). Although Public Counsel does not concede these criticisms and in fact believes that its estimates are more reasonable. But if these amounts were added to Mr. Biddy's $38.5 M cost estimate, the cost of flood proofing and refurbishing the river treatment plant would still only total $53.7 M. Hypothetically, if all these issues were conceded, and yet another $1 M was thrown on top of the estimate to address "emergency access issues", the total cost estimate for flood proofing and refurbishing the river treatment plant would still remain below $55 M--still $15 M less than the $70+ M total for construction of the new groundwater facility to floodproof and rehabilitate the river plant is wholly unsupportable on this record. Certainly, the substantial and compelling record developed in this case inescapably justifies a large disallowance.

Staff attacked the credibility of Public Counsel witness Mr. Biddy for a perceived failure to fully investigate certain issues. Ibid., pp. 23-25. By contrast, Staff prudence witness Jim Merciel more or less adopted Company's position regarding prudence as his own and conducted no formal analysis himself regarding the comparison costs between the river and groundwater alternatives. (Tr. 1503-1504). Although Mr. Merciel claims that Staff conducted a prudence review of the alternatives available to Company during the pendency of Case No. WA-97-46, he could produce no Staff work papers to support that prudence review. (Tr. 1529-1530). Mr. Merciel acknowledged generally approaching Company's proposals with a set expectation that they would be prudent. (Tr. 1497). While not developing his own estimates, Mr. Merciel stated that he reviewed Company's estimates and relied upon "common sense and the appearance of the

numbers that the Company gave." (Tr. 1505). Even so, Mr. Merciel did not reach the conclusion that construction of a groundwater facility was the most economical approach, stating his opinion that other intangible characteristics (which were not quantified) figured into his recommendation. (Tr. 1505-1507). Mr. Merciel quibbled with Mr. Biddy regarding how "floodproof" the river treatment facility could be, but he did acknowledge that the risk of damage to the intact structures of the new groundwater facility creates a possible flood risk as well. (Tr. 1503). The record is clear that the new facility does not eliminate flood risk.

It is the Commission's power and responsibility to ascertain the value of the property of water corporations committed to serve the public. Section 393.230 RSMo. 1994 authorizes this Commission to ascertain such value and can be based upon any source of competent and substantial evidence presented to it at an evidentiary hearing. Public Counsel contends that the only just and reasonable way to value the St. Joseph water treatment facilities is to base it upon the most economic and prudent method that Company could have used to improve its water treatment facilities. Accordingly, Public Counsel recommends that the Commission set a value on such facilities at a level that would have been required to floodproof and rehabilitate the river treatment plant--$38,567,838. If the Commission has lingering doubts the Public Counsel has not developed cost estimates on any cost components that are sufficiently high enough, those components could be adjusted upward, but based upon the record in this case it would be nearly impossible to reach an estimate equal to the excessive cost incurred to build the new groundwater facility, and thus a substantial disallowance is necessary.

III. USED AND USEFUL CAPACITY ADJUSTMENT

Staff agrees with Public Counsel that current ratepayers should not be required to pay for larger excess capacity costs until those larger capacities are actually being "used" to meet higher capacity demands. Staff's Initial Brief, p. 28. Staff recommends that the appropriate capacity for the Commission to recognize for purposes of rate base for the St. Joseph water treatment facilities is 23 million gallons a day (MGD). Id. However, Staff merely recommends that a few certain components be excluded from the construction costs, proposing a disallowance of approximately $2.2 M. Id.

Public Counsel actually recommends an even higher capacity be recognized by this Commission--the projected maximum day water usage after two years of growth (24.135 MGD for the year 2002). Public Counsel recommends a "used and useful" capacity adjustment that places 24.135 MGD above the denominator of 30 MGD plant capacity. (Ex. 20, pp. 24-25). This simple ratio generates a percentage of 80.45%.[3] (Ex. 20, Sched. TLB-13). Mr. Biddy allows for a two-year growth in demand despite the fact the maximum daily flow has stagnated over the last few years and indications are that future growth will be slow at best in St. Joseph, Missouri. (Ex. 20, p. 6).

Company criticizes Public Counsel's capacity adjustment in its Initial Brief, claiming that it would "punish" Company for taking advantage of economies of scale. Ibid., p. 28. Whether or not Company has made an economic decision that does capitalize upon economies of scale remains to be seen, but the important thing to recognize about Public Counsel's capacity

[3] It is important to recognize that this percentage should be applied to whatever valuation the Commission adopts in this case. All valuations recommended by Staff, Company, Public Counsel and the Industrial Water Users are based upon the construction of a facility that would have a capacity of 30 MGD. Thus the Commission should only allow in this rate case 80.45% of the recognized valuation whether that valuation is based upon costs incurred to build the new groundwater facility or whether the Commission's valuation is based upon the estimated costs to floodproof and refurbish the river treatment plant.

adjustment is that is not designed to either reward or punish Company's decisions regarding capacity. Public Counsel is simply asking the Commission to exclude from rate base the cost of constructing capacity that is not currently used and useful. Public Counsel's recommendation allows carrying costs to accumulate on the excess capacity until such time that that excess plant is used and useful to provide service to customers. By allowing carrying costs to accumulate, Company is neither rewarded nor punished, but the Commission is accurately placing upon the customers only the cost of the capacity that was built to serve them. This is simple fairness among ratepayers that treats Company neutrally.

If and when future customers demand greater capacity, rate base can be increased to include the excess capacity that was properly excluded in this. Company fully recovers its investment at a later date, and the responsibility for paying for capacity is fairly distributed between current and future customers based upon the capacity that was actually needed to serve each group. If Company is right and customer demand rises in the future then Company will be able, in the appropriate rate case, to recover the full valuation of its investment.

Much like the traditional exclusion of Construction Work In Progress (CWIP) and the provision for Allowance for Funds Used During Construction (AFUDC), a utility is allowed to accumulate carrying costs for an item that is not yet used and useful. These mechanisms, like the used and useful capacity adjustment, encourage prudent, forward looking planning, but not at the expense of current customers for whom the construction expenditures do not benefit.

IV. PREMATURE RETIREMENT OF RIVER TREATMENT PLANT

Company acknowledges that it would be impossible in this case to develop accurate depreciation rates for the retired river water treatment plant in St. Joseph. Company's Initial

Brief, p. 99. The reason such rates cannot be developed is that the last depreciation study, performed by the Company in Case Nos. WR-97-237 and SR-97-238, was based upon flawed data and was therefore inaccurate. Staff's Initial Brief, p. 10. Further, a new study could not be performed in the instant case because Company failed to provide the necessary data, even though specifically requested by Staff in a Data Request, in a timely manner. (Mathis Direct, Ex.44, p. 2). Company, and no other party, bears the burden of proof in a rate case §386.430 RSMo. 1994.

Company states in its Initial Brief that it is in agreement with Staff's position that a depreciation study should be performed regarding the retired river water treatment plant in St. Joseph "so that the accuracy of the majority of the reserve and depreciation rates for the major accounts of MAWC can be evaluated before an amortization is initiated for a single account." Ibid. at 99. Staff recognizes that it would be inappropriate to allow Company an amortization for a single account in the absence of accurate data. Id. at p. 10. However, it proposes that Company be permitted to "preserve the estimated unrecovered investment of $2,832,906 until [a] depreciation study is performed." Id. In the meantime, no amounts determined to be inappropriate later after a depreciation study could be refunded to consumers. Staff is apparently unconcerned that any and all inaccurate charges would be borne by the consumers while we wait for details that Company was legally required to produce in this case.

Public Counsel submits that this proposal is extremely ill-founded, as it would allow Company to continue to earn a return on the estimated undepreciated investment in the retired plant, which is no longer "used and useful" and is providing no benefit whatsoever to consumers, and for as long as it takes Staff to determine how much the customers have been overpaying. It is no wonder that Company has aligned itself with Staff on this issue. If the position taken by

Staff and Company regarding premature retirement is adopted by the Commission, Company will be rewarded monetarily for its inability or unwillingness to provide accurate data from which depreciation rates could have been determined in a timely fashion, and would be receiving full rate base treatment for two water plants simultaneously, only one of which, of course, is operational. In any event, Public Counsel contends that none of the undepreciated river plant should be charged to consumers.

Since Company bears the burden of proof in every rate case, and since it has utterly failed to carry its burden with regard to providing the data which would have enabled accurate depreciation rates to be calculated in this case, it must not receive rate base treatment for the estimated undepreciated investment in the retired water plant during the pendency of any depreciation study which the Staff may undertake in some future rate case. Such a result would be patently unfair to consumers and should be rejected out of hand by the Commission.

V. ACCOUNTING AUTHORITY ORDER ISSUE

All of the arguments raised by Company in its Initial Brief regarding its request for recognition of an Accounting Authority Order deferral were adequately addressed in the Initial Brief of the Public Counsel and in the Initial Brief of the Commission Staff.

VI. RETURN ON EQUITY

Company takes the position that neither Public Counsel's recommended return on equity (9.92%) nor Staff's recommended return on equity range (9.5% to 10.75%) is "adequate to provide MAWC with an adequate rate of return given its unique risk characteristics." (Initial

Brief, p. 79). The "unique risk characteristics" identified by Company appear to revolve around its "small size." Id. at pp. 80-83, 86. Company omits mention of the fact that it is the second largest regulated water company in Missouri; only St. Louis County Water Company, owned by the same parent (American Water Works) is larger. If, to use Company's analogy, MAWC is a "small ship" on the ocean with less chance of weathering a storm than a large ship (p. 80), but American Water Works (AWK) is a giant umbrella protecting MAWC from the storm in the first place.

Company witness Walker calculated a DCF cost rate for his selected comparable group of companies of 10.5%, then cautioned against relying on the traditionally-employed DCF model, claiming that the DCF in this case "understates [the] common equity cost rate and should therefore be given less weight in any analysis." Id. at p. 83. As pointed out by Staff, the Commission has for at least twenty years preferred the DCF method of determining return on equity, and Mr. Walker offers no valid reason that would lead one to believe it would not be the most appropriate method in this case as well. (Initial Brief, p. 32).

Company goes on to remark that Public Counsel witness Burdette calculated a higher common equity cost range in its last rate case, when A rated public utility bonds were yielding 60 basis points less than they are today; Company argues that the fact that Mr. Burdette's calculated cost of common equity in this case is lower in this case calls into question the reasonableness of his conclusions. Id. at p. 87. It should be noted that Company's argument is meaningless because the spread between stocks and bonds is not a constant, and therefore, cannot be the basis for a valid comparison between such separate calculations. Further, the determination of cost of common equity is in each and every rate case the independent product of

forward-looking financial analysis, and the result in one case cannot be compared meaningfully with the result in another.

The Commission should adopt Public Counsel's recommendation and allow Company the opportunity to earn a 9.92% return on common equity.

VII. RATE DESIGN

A. District Revenue Responsibility

Public Counsel is in general agreement with the arguments presented in initial briefs that explain how Single-Tariff Pricing (STP) is not appropriate for application to Company's seven distinct, diverse, and non-interconnected water system. (districts). Public Counsel believes that District-Specific Pricing (DSP) is more just and reasonable for application to this water company as it is currently situated. As described in Public Counsel's Initial Brief, the most fair approach to this issue in this case involves significant movement towards DSP and toward cost of service rates in each of the districts, up to a total district revenue increase of 50% (the "50% cap"). This cap is the best method of insuring significant movement towards cost of service among the districts while also balancing rate shock and other equity concerns. As Staff's recommendation issue has evolved during this proceeding, it has moved closer to Public Counsel's recommendation, and in its final form, also balances the mitigation of rate shock along with the benefits that accrue from cost of service pricing in the various districts.

The regulatory expert sponsored by parties who advocate for STP, Dr. Jan Beecher, lended theoretical support to an approach that moved rates gradually from one extreme pricing methodology to another. Dr. Beecher believes that the need for consumers to become gradually accustomed to higher rates if a Commission was moving towards STP, it would be advisable to

cap the rates in the higher costs districts and gradually increase rates in the lower cost districts. (Tr. 423). Likewise, Dr. Beecher acknowledged that if a Commission wished to move from a STP pricing methodology toward a DSP pricing methodology, the same general concept would apply and rates should be moved gradually in the desired direction. (Tr. 423).

The various rate design components recommended by Public Counsel produce a middle-of-the-road compromise approach to this highly charged issue. This recommendation is the more fair to Company's ratepayers overall.

B. **Phase-in Recommendations**

Company throws out two arguments in opposition to the phase-in recommendations in this case: 1) Financial Accounting Standard 92 (FAS 92) purportedly would not permit the Commission to approve a phase-in, and 2) The Commission is not statutorily authorized to approve phase-ins. These arguments, however, do not present roadblocks, as the Commission does possess the necessary authority to approve a phase-in provided that the phase-in is designed to provide the utility with full recovery of its revenue requirement and the carrying costs incurred during the phase-in period. Both Public Counsel and Staff design their phase-in recommendations in this manner and both parties are in agreement that such a phase-in is necessary to mitigate the rate shock that would otherwise occur under any of the revenue requirements recommended in this case and that it is necessary to produce just and reasonable rates. (Ex. 34, Sched. RWT-2 through RWT-4, RWT-6; Ex. 35, Sched. RWT-5 revised; Staff Initial Brief, pp. 69-71).

The basis of the opinion that FAS 92 prevents phase-ins is the testimony of Company witness Mr. Hamilton (Ex. 3, p.9). Mr. Hamilton is the hired consultant that would likely be

retained by Company to render an opinion on this matter. Company Initial Brief, p. 72. There are several problems with his contention. First of all, the Commission is not bound to follow Financial Accounting Standards when setting rates. Secondly, FAS 92 does not apply to Public Counsel's proposed phase-in. (Ex. 35, pp. 3, 7-9). Thirdly, Financial Accounting Standard 71 allows Company to change its accounting methods to allow the implementation of regulatory decisions. Id., pp. 3-6. Public Counsel's witness Trippensee explains that Public Counsel phase-in recommendation meets the three requirements of FAS 71 with regard to accounting treatments ordered by regulatory agencies when they diverge from otherwise generally accepted accounting principles. Id., pp. 3-4. Mr. Trippensee further explains that the concerns that led the adoption of FAS 92 referred to developments in the electric industry and these concerns are not applicable to the regulation of the water industry. Id., pp. 7-9.

Company's Initial Brief also points out that there is express authority for Phase-ins in § 393.155 RSMo. 1994. Company then argues that because this statute refers to electric corporations and not water corporations, by implication, phase-ins for water companies are prohibited. Company's Initial Brief, pp. 76-77. Company's legal interpretation on this matter is flawed. The fact that the Missouri Legislature adopted language describing specific requirements regarding phase-ins for electric corporations does not necessarily imply a prohibition of phase-ins in other industries. Company does not cite to any specific statutory language prohibiting the Commission from ordering any type of phase-in.

The Commission has not only adopted phase-ins with regard to electric rate increases; the Commission has adopted rate phase-ins in recent water cases. See United Water Missouri, Inc., Case No. WR-99-326, Report and Order issued September 2, 1999. The Commission practice of implementing phase-ins where rate shock would otherwise be great is consistent with the broad

statutory discretion granted to the Commission in setting just and reasonable rates. See Office of the Public Counsel v. PSC, 938 S.W.2d 393,344 (Mo.App.W.D.1997). The Commission is granted broad ratemaking authority pursuant to Chapters 386 and 393 as it relates to water corporations, and in addition, the Commission has all of the powers necessary and proper to enable it to fulfill its obligation to set just and reasonable rates. §386.040 RSMo. 1994.

Several statutes address what the Commission may do with regard to one industry and do not imply that the opposite applies to other industries. For example, § 393.135 RSMo. 1994 prohibits the Commission from including in rates any cost of Construction Work In Progress (CWIP) with regard to electric corporations. If Company's argument was analogized to this statute; the Commission would be required to allow CWIP for industries other than electric utilities. The Commission has consistently prevented the recognition of CWIP in all regulated utility industries because such costs are not reflective of used and useful plant. § 393.135 does not prevent the Commission from excluding CWIP from the rates of water corporations.

The phase-in proposals of Staff and Public Counsel are legally sound and reasonable given the dramatic impacts that would otherwise occur to the consumers in this case.

VIII. CONCLUSION

Wherefore, Public Counsel respectfully requests that the Commission disallow all capital improvements in the St. Joseph District that are deemed above a prudent and reasonable level of costs for providing safe and adequate water service to that district, that the Commission further adjust the valuation of those facilities to exclude capacity that is currently in excess of demands projected for the next two years, and that the Commission further base its revenue requirement and rate design determinations in this case in a manner consistent with the arguments contained in Public Counsel's briefs.

The rate design issues in this case are very complicated and there is much interrelationship between district, class and phase-in recommendations. If the Commission wishes to mix components from various parties or adopt a compromise position between the recommendations of different parties, it may present the parties with scenarios to assist in developing a final decision on this matter.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing has been mailed or hand-delivered to the following on this 2nd day of August, 2000:

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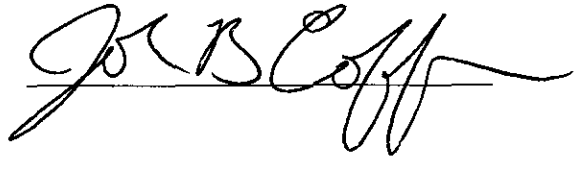

MISSOURI-AMERICAN WATER COMPANY

ST. JOSEPH

SOURCE OF SUPPLY AND TREATMENT ALTERNATIVES

ANNUAL CASH FLOW

ALTERNATIVE I-A

SURFACE WATER AT EXISTING SITE - NON-PHASED

02/07/95

YEAR	CAPITAL EXPENDITURES	FACILITIES IN SERVICE	FACILITIES TO BE RETIRED	O&M COSTS	REASON FOR CHANGE
1995	$700,000	(Design)		$1,600,000	
1996	$2,000,000	(Design, Land Aquisition, etc.)		$1,600,000	
1997	$10,000,000			$1,600,000	
1998	$18,000,000	Filters, Superpulsators, Presedimentation Clarifier	Basins, Filters	$1,900,000	Enhanced Coagulation (EC)
1999	$12,100,000	Chemical & Operations Building, Distributive & Transfer Pump Stations, Clearwell	Distributive & Transfer Pump Stations	$2,100,000	GAC
2000	$10,000,000	Raw Water Intake, Low Service Pumps, Access Rd.	Main Intake, Low Service Pumps	$2,100,000	
2001				$1,900,000	Staff Reduction (4)
2002				$1,900,000	
2003				$1,900,000	
2004				$1,900,000	
2005	$6,000,000			$1,900,000	
2006	$4,500,000	Ozone Facilities		$1,900,000	
2007				$1,700,000	Ozone Replaces EC
2008				$1,700,000	
2009				$1,700,000	
2010				$1,700,000	
OTAL	$63,300,000				

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